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Assante® WEALTH MANAGEMENT

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MONEY *matters*

OVERHAUL OF EXEMPT LIFE INSURANCE POLICY RULES IN 2017

Currently, virtually all permanent life insurance policies in Canada are structured to be exempt life insurance policies. This means that the investment earnings associated with the cash value accumulation in the policy are not subject to annual taxation. In addition, the death benefit proceeds (including the cash value) are received tax-free upon the death of the life insured.

The rules in the Income Tax Act (the "Act") that determine if a life insurance policy is an exempt policy were designed to ensure that the tax advantages available to exempt life insurance policies are not extended to life insurance policies that are mainly investment vehicles with only superficial life insurance protection. These rules are being overhauled effective January 1, 2017.

These updates to exempt test rules are significant and will generally negatively impact the level of tax-deferred growth allowed within universal life or whole life policies.

According to a Tax Topic article published on the subject of "The Exempt Test" by Manulife's tax, retirement & estate planning services, "the general conclusions regarding the impact of the changes may be summarized as follows:

- A reduction in the maximum premiums and/or deposits permitted in an exempt policy
- A lengthening of the "quick-pay" period possible under any given set of assumptions in a life insurance policy illustration
- Lower permissible maximum cash value accumulations inside exempt insurance policies."

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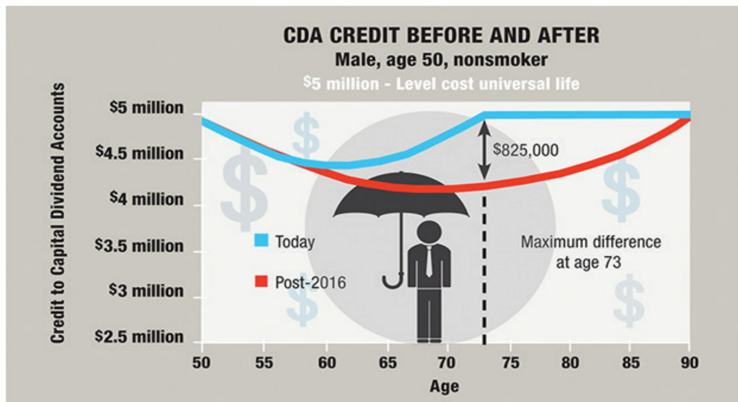
The Effect on Corporately Owned Policies

For life insurance policies owned by corporations, the policy proceeds paid upon death to the corporation will be credited to the Capital Dividend Account (CDA), and can be paid out to the shareholders and their estates, tax-free, to the extent of the CDA credit arising from the policy proceeds. In addition, these capital dividends can be used to reduce capital gains arising upon death from the deemed disposition of the shares owned by the shareholders.

The capital dividend account credit for life insurance policies with level cost of insurance that were issued on or after January 1st, 2017 will be reduced compared to those issued before 2017. Also, as a result of the changes to exempt test rules in 2017, the adjusted cost base of the policy would take much longer to grind down to 0, which could lead to lower CDA credits in the early years for corporately owned life insurance policies.



Source: BMO Insurance

Effect on Collateral Insurance Deduction

Policy holders who use their policy as collateral security for investment loans may be able to deduct a portion of the premium for the policy. Starting 2017, the amount of the deduction will be significantly reduced.

The new measures will take effect on January 1st, 2017 and will only apply to policies issued after 2017. Policies issued before 2017 will be grandfathered as long as certain conditions are met.

Now is a good time to review your life insurance needs with your financial advisor, and ensure that if you need a universal life or whole life policy whether for personal or corporate purposes, that you purchase it before the end of 2016 to be able to benefit from the more favourable taxation of these policies.

MAXIMIZE CHARITABLE GIVING BY USING A HOLDING COMPANY

A small business can be a powerful engine for creating wealth. Small businesses are also the biggest creators of jobs in Canada. According to Statistics Canada's Key Small Business Statistics survey, "Small businesses account for more than 98 percent of all firms in Canada and proportionally play a large role in net job creation, creating 77.7 percent of all private jobs from 2002 to 2012"*.

According to the Canadian Federation of Independent Business (CFIB), close to 50% of business owners plan on exiting their business in the next five years with more than 75% planning to exit within the next 10 years.** This provides a great opportunity for effective tax planning and charitable gift planning strategies for business owners.

Our tax rules provide a favourable tax rate for Canadian-Controlled Private Corporations (CCPC). The first $500,000 of income of a Canadian-Controlled Private Corporation (CCPC) enjoys a very low federal small business tax rate of 10.5%. The small business rate is available on active business income up to the amount of the Business Limit. The federal business limit of $500,000 begins to be reduced when a CCPC's taxable capital reaches $10 million, and is eliminated when taxable capital reaches $15 million.

In 2016, CCPCs that are eligible for the small business deduction pay the following combined federal and provincial (Ontario) tax rates on different types of income***:

General Rate	26.50%
Small Business (to $500,000)	15.00%
Investment	50.17%

When money is withdrawn from the corporation, it will be taxed at the top marginal tax bracket of the owner, depending on the amount of income he/she declares in that year. If the owner's net income is over $220,000 in Ontario, and the amount that is withdrawn from the corporation is in the form of salary, the income would be taxed at 53.53%. If it is withdrawn in the form of non-eligible dividends then it would be taxed at 45.3%.

Locked-up Capital in Holding Companies

The cash inside an operating company can be transferred to a holding company using inter-corporate dividends on a tax-free basis. Business owners set up holding companies mainly either to protect themselves from claims of creditors or as a retirement strategy to set up an investment portfolio inside the corporation without having to withdraw any funds, and then to withdraw the funds as dividends during retirement.

While the low tax rate for small businesses helps spur growth in the business sector and helps the business owners accumulate wealth, this wealth creates complexity.

The biggest dilemma for most business owners is how to extract the funds in their corporations and holding companies without paying personal taxes at very high rates, as those funds are taxed as personal income upon extraction from the company. There can be substantial reduction in the value of a company upon withdrawal of the funds. For example, assuming a 45% tax rate, a holding company with a value of $3,000,000 is actually only worth $1,650,000 after tax.

Therefore, it is understandable that business owners are always looking for tax effective methods of extracting their locked up capital from their corporations.

Charitable Giving Considerations for Business Owners

When a corporation makes a charitable gift, the corporation receives a tax deduction, which reduces its income and will therefore reduce the taxes it has to pay. When a charitable gift is made personally, it results in a charitable donation tax credit which will reduce tax that was otherwise payable. Both on a personal level and corporate level, the limit on the amount of the charitable donation that may be claimed in a given year is 75% of net income and if the credit or deduction is not used, it can be carried forward for 5 years. Also, capital gains are eliminated for both personal and corporate gifts of public securities when the gift is made in kind.

A big difference between personal and corporate donations is that in the year of death for an individual, the limit is 100% of net income and any excess can be carried back one year.

"The capital dividend account credit for life insurance policies with level cost of insurance that were issued on or after January 1st 2017 will be reduced compared to those issued before 2017."

The Key Advantage of Giving Through a Private Corporation

Private corporations have a notional account called the capital dividend account (CDA). The CDA creates a unique financial planning opportunity for business owners when it comes to philanthropic tax planning and makes charitable giving through a corporation extremely attractive.

The CDA does not appear on the corporation's balance sheet and is a notional account that keeps track of the amounts that are eligible to be flowed to a shareholder on a tax-free basis, and is a cumulative total that is often recorded in the notes to the financial statements. The CDA is a very important notional account as it allows a shareholder to withdraw funds on a tax-free basis from the corporation.

When a publicly traded security is sold by a corporation, 50% of the capital gain is taxable as income. The remaining 50% is not taxable and is credited to the CDA.

When publicly traded securities with accrued gains are donated to a charity in kind, the CDA is credited with the non-taxable portion of the capital gain. Since donation of securities in kind to a charity eliminates 100% of the capital gain, 100% of the capital gain will be credited to the CDA in this case. Therefore, by donating securities in kind to a charity, the entire capital gain can be withdrawn on a tax-free basis from the CDA .

While the decision with regards to making a charitable gift is personal and is based on the philanthropic intentions of the donor, the decision as to whether to make a gift personally or through a corporation often hinges on the tax benefits. Therefore, the ability to extract money on a tax-free basis from a corporation through the CDA is a major consideration for shareholders as to where the source of the charitable gift should come from.

The proceeds of a corporately owned life insurance policy also flow through the CDA and can be paid to the shareholders on a tax-free basis after deduction of the adjusted cost base of the policy.

The use of life insurance together with donation of securities in kind can allow business owners to multiply the results of their giving and minimize their estate tax liability. The upcoming changes to insurance rules in 2017 will reduce the maximum premiums and/or deposits permitted in an exempt policy and therefore, will reduce the possibility of accumulating funds on a tax-sheltered basis in a corporately owned policy. Therefore, now is a good time for business owners to review and update their retirement and charitable giving strategies.

- *Source: Statistics Canada Key Small Business Statistics – August 2013 https://www.ic.gc.ca/eic/site/061.nsf/eng/02806.html
- **Source: CFIB's study on business succession planning that was released in November 2012. The study was conducted over the period from March 9 to May 4, 2011. Over 8,300 Canadian business owners responded to the study.
- *** Source: http://www.sslgroup.ca/?section=tax-rates

MAKING SENIOR CARE MORE AFFORDABLE: TAX CONSIDERATIONS FOR YOU & YOUR FAMILY

One of the biggest concerns for families of seniors requiring residential facility care is how to make that care more affordable. The federal and Ontario governments provide many tax credits that can improve a family's cashflow by reducing the costs of care. Here are some frequently asked questions we often hear:

1. Are all costs of living in a retirement residence eligible medical expenses?
Retirement home fees are broken down into two parts: the first is the cost of accommodation, which is essentially the cost of renting a unit in the residence. The second is the cost associated with care such as nursing salaries, meal preparation, and housekeeping. The institution will provide a receipt detailing the breakdown. Only those fees relating to the cost of care are tax deductible as eligible medical expenses. The accommodation charges are generally eligible for the Ontario Trillium Benefit (non-taxable monthly payment).

2. What tax savings will result from claiming care costs?
Eligible medical expenses are reduced by 3% of a person's net income, with a maximum grind of $2,208 for 2015. The remaining eligible portion generates a non-refundable credit at a rate of 20.55% for 2015.

3. Are there any certifications required to claim the retirement home care costs?
Yes. Typically, Form T2201 (Disability Tax Credit Certificate) is completed by a qualified medical practitioner and sent to the Canada Revenue Agency for review and approval. This form certifies that the senior has a severe and prolonged impairment in physical or mental functions. As an alternative, when certain medical conditions do not qualify for the certificate, a letter from a qualified medical practitioner may be sufficient if it states that the patient is likely to be dependent on others in order to perform daily living activities and, therefore, requires care in a facility.

4. If the senior is approved for the disability tax credit (worth about $1,500 in tax savings per year), can this be claimed in addition to the costs of the retirement care?
No. If the senior claims the full care costs of the retirement home, they cannot claim the disability tax credit.

5. I've heard that retirement care costs could also be claimed as "attendant care" costs. How does this work?
The care costs also qualify as "attendant care" costs but these are limited to $10,000 per year ($20,000 in the year of death). It is possible to combine the disability tax credit claim with up to $10,000 of attendant care costs. This should be considered in the case where a senior moves into a retirement residence at the end of the year and only has one or two months of care costs in the retirement home.

6. The doctor indicated that my parents disability occurred three years ago while they were living independently. Is there any tax relief?
Yes. Once the Canada Revenue Agency approves the certification, you can amend your parent's prior three tax returns to claim the disability tax credit. This could generate a tax refund of about $4,500.

7. I pay for my parents care costs. Can any of the deductions be transferred to me?
You can claim the medical expenses of extended family members provided that your parent is dependent on you for support. The amount you may claim will be reduced by 3% of your parents income to a maximum of $2,208 in 2015.

8. What other medical expenses can be claimed by seniors?
Many overlook the following items: diapers (if certified as incontinent), batteries for hearing aids, prescription glasses, scooters or other walking aids, orthopedic shoes, pharmaceutical prescriptions, and cataract lenses. You will need to submit appropriate receipts to support the claims.

> "The CDA creates a unique financial planning opportunity for business owners when it comes to philanthropic tax planning and makes charitable giving through a corporation extremely attractive."

9. What if my parent has private insurance?
Premiums for private insurance are also considered eligible medical expenses. Remember to reduce any claim for prescriptions, or other medical devices or services, by the reimbursement received from the plan.

10. Are there any ways to save Estate Administration Tax (i.e., "probate fees")?
While it may not be possible to amend a will if the senior lacks the appropriate capacity, there are circumstances when a trust can be used to avoid the 1.5% Estate Administration Tax.

To ensure that you are taking advantage of every tax break available, please contact us for a review of your family's tax situation.

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Karen is a partner in Crowe Soberman's Tax Group. She co-leads the firm's Succession, Retirement and Estate Planning (SuRE) Group. Karen takes a holistic approach to tax planning, looking beyond meeting the initial requests of her clients and proactively addresses needs that will arise in the future. Her long-term view has resulted in success for her clients' businesses and personal lives.

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THE MCMICHAEL MOONLIGHT GALA 2016 – THE MOST SUCCESSFUL FOR THE GALLERY TO-DATE

On June 4th 2016, I had the pleasure of chairing the 5th annual McMichael Moonlight Gala, the signature fundraiser celebrating the 50th anniversary of the McMichael.

Amidst soaring pines, in the spectacular setting of the McMichael Canadian Art Collection, over 600 guests convened to celebrate the 50th anniversary of the gallery and help raise funds for the preservation of Canadian art and to support the excellent educational programming and exhibitions at the McMichael.

With the help of our generous sponsors, donors, and guests, we were able to raise over $350,000 net for the McMichael and produce a beautiful 50th anniversary commemorative book to celebrate the occasion and thank all the volunteers, board members, and donors, who have helped shape the history of the McMichael over the last fifty years.

I am thrilled to be appointed chair of the McMichael Moonlight Gala 2017, which will be the signature fundraiser for the McMichael, celebrating the 150th anniversary of the Confederation and will mark the 100th anniversary of death of Tom Thomson.

Tina Tehranchian with Yannick Bisson (star of Murdoch Mysteries) & Shantelle Bisson

From left to right: Nathalie Mercure (Interim CEO of the McMichael), Dr. Sarah Stanners (Chief Curator of the McMichael), and Tina Tehranchian

ABOUT THE EDITOR

Tina Tehranchian MA, CFP, CLU, CHFC, is a Branch Manager and Senior Financial Planner with Assante Capital Management Ltd., one of Canada's largest wealth management firms, offering integrated financial solutions to create wealth and prosperity for you and your family. The 750 advisors serve over 300,000 Canadian families across the country and take pride in the exceptional service they offer to clients through trusted face-to-face relationships and a level of service excellence second to none. Money Matters is published as a special service for clients of Tina Tehranchian.

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"You can claim the medical expenses of extended family members provided that your parent is dependent on you for support."
- Karen Slezak & Alan Wainer